No. 95-154

(5)

Supreme Court, U.S.
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In the

Supreme Court of the United States

October Term, 1995

IN RE WORLDS OF WONDER SECURITIES LITIGATION

ROSETTA MILLER; WALTER UNTERMEYER; ALAN NISSELSON; TRUDY WHITMAN NISSELSON; PAUL GREENSTEIN, HOWARD H. WESTON, AS TRUSTEE FOR THE FLORIDA MUNICIPAL, INC., RESTATED DEFINED BENEFIT TRUST AND PLAN; and SYLVIA WIND, on behalf of themselves and the certified class of purchasers of the securities of Worlds of Wonder, Inc.,

Petitioners,

v.

ANGELO M. PEZZANI; DONALD D. KINGSBOROUGH; RICHARD B. STEIN; JOHN B. HOWENSTINE; BARRY H. MARGOLIS; DELOITTE & TOUCHE; SMITH BARNEY, HARRIS UPHAM & CO.; JOSEPHINE ABERCROMBIE; and WORLDS OF WONDER SHARES PARTNERSHIP,

Respondents.

On Petition For A Writ Of Certiorari
To The United States Court Of Appeals
For The Ninth Circuit

RESPONDENT SMITH BARNEY'S BRIEF IN OPPOSITION

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QUESTION PRESENTED*

Did the court of appeals, applying settled legal principles to its *de novo* review of a detailed factual record, properly affirm the district court's summary judgment in favor of respondent Smith Barney, particularly where petitioners did not challenge on appeal Smith Barney's establishment, through undisputed evidence, of its "due diligence" defense to petitioners' claims under the Securities Act of 1933 and the absence of scienter on petitioners' claim under the Securities Exchange Act of 1934?

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* The remaining questions presented by petitioners are not addressed to respondent Smith Barney Inc. ("Smith Barney," formerly Smith Barney, Harris Upham & Co. Inc.).

OTHER PARTIES BELOW

In addition to parties named in the caption, petitioners asserted claims below against Dean Witter Reynolds, Inc. (in the district court) and Robinson Interests, Inc. (in the district court and court of appeals).

DISCLOSURE PURSUANT TO RULE 29.1

Pursuant to Rule 29.1, Respondent Smith Barney Inc. (formerly Smith Barney, Harris Upham & Co. Inc.) states that the following parent, subsidiary or affiliated companies have issued securities to the public: The Travelers Group, Inc.; Smith Barney Holdings, Inc.; and Commercial Credit Co.

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STATEMENT OF THE CASE

Worlds of Wonder ("WOW") was a toy company founded in 1985. During its first two years of existence, WOW developed the nation's top-selling toy for each of those Christmas seasons. In 1985, WOW's animated talking bear, Teddy Ruxpin, headed the "wish list" of millions of children. In 1986, WOW's "Lazer Tag" game was another runaway best-seller.

In early 1987, WOW introduced a greatly expanded product line and extensions to its existing toys, all of which were greeted with enthusiasm by retailers, consumer marketing and industry experts. Based upon the anticipated increased demand for its products, WOW sold $80 million in convertible debentures on June 4, 1987 to enhance its product development and manufacturing capacity. The debenture prospectus, which reflected the intensive "due diligence" investigation conducted by underwriter Smith Barney, emphatically warned of the significant risks faced by this thinly-capitalized two-year old company in a highly volatile industry.

The strongly-worded prospectus warnings proved to be highly effective. The WOW debentures were rated as "junk bonds" by Standard & Poor's and Moody's investment services and paid a premium 50% above the prevailing rate for investment grade securities. As the district court later observed, "[i]t was obvious to any reasonable investor that WOW would be unable to survive any unanticipated shortfall in its revenues, and this risk was well known to the market." *In re Worlds of Wonder Securities Litigation ("WOW")*, 814 F. Supp. 850, 854 (N.D. Cal. 1993).

The prospectus warnings also proved to be prophetic. As investors had been cautioned, WOW was not able to come up with a new hit toy for 1987, and Teddy Ruxpin and Lazer Tag fell out of favor with America's pre-teens. The profound seasonality of the toy business, as had been forewarned, prevented WOW from recovering the costs of its expansion incurred during the first half of 1987 when it did not achieve its projected sales during the second half of that year. Unable to finance new lines of toys, WOW declared bankruptcy in late 1987.

Although securities litigation inevitably accompanied WOW's downfall, it was immediately apparent that WOW's debenture prospectus disclosed precisely the risks and problems that ultimately caused the company's demise. In 1988, the district court initially dismissed petitioners' complaint, without prejudice, and warned that **"it is clear that some of the risks which plaintiffs claim were omitted were in fact disclosed in the prospectus."** *WOW*, 694 F. Supp. 1427, 1434 (N.D. Cal. 1988) (the district court "declining at [this] point in the litigation to sift through the individual allegations and decide, as a matter of law, which risks were actually disclosed"). Finally, after more than 80 depositions and "a tortured five years of proceedings," *WOW*, 35 F.3d 1407, 1412 (9th Cir. 1994) (App. 5),[1] the district court carefully scrutinized the factual record and each of petitioners' allegations.

In a ruling that the court of appeals described as "an exhaustive opinion," *WOW*, 35 F.3d at 1412 (App. 5), the

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[1] "App. ___" references are to the pages of the court of appeals' opinion as they appear in the Appendix submitted with the Petition.

district court granted summary judgment in favor of all respondents as to the textual portions of the debenture prospectus.[2] Following its painstaking review of each challenged prospectus disclosure, the district court concluded:

> "[I]f courts were to allow plaintiffs in securities fraud cases to survive summary judgment in the face of disclosures this detailed and specific, there would be no point for companies to disclose risks at all." *WOW*, 814 F. Supp. at 866.

The district court's decision also held that petitioners had failed to establish scienter, saying there was "insufficient evidence, as a matter of law, for the jury to find intent to deceive on the part of any defendant in connection with WOW's securities offerings." *Id.* at 873. With respect to Smith Barney, the district court further concluded that "as part of Smith Barney's 'due diligence' inquiry, Smith Barney specifically sought and received assurances from Deloitte on the [challenged portions of the WOW financial statements]. Thus, Smith Barney clearly exercised reasonable care, and it did not have any reason to know that there were any errors in the financial statements." *Id.* at 868.

Relying on the same fact-specific arguments that are now before this Court, petitioners twice sought reconsideration from the district court. Because these arguments "present[ed] no new issues of law or fact," and

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[2] Respondent Smith Barney also asserted a "due diligence" defense against liability under Sections 11 and 12(2) of the 1933 Act, and the compelling factual basis for this independent defense has never been contested by petitioners.

there was no showing that the court's order was in error, the district court denied reconsideration. *Id.* at 874. Undeterred, petitioners sought *de novo* review by the Ninth Circuit Court of Appeals, but did not challenge any aspect of Smith Barney's independent "due diligence" defense or the district court's ruling that Smith Barney lacked scienter.

The court of appeals affirmed summary judgment as to the textual portions of the prospectus with its own detailed analysis of the evidence. It methodically reexamined each of the disclosures now challenged by petitioners and concluded that there were no material misstatements or omissions. The court of appeals also made clear that any reference to the "bespeaks caution" doctrine "merely represent[ed] the pragmatic application of two fundamental concepts in the law of securities fraud: materiality and reliance." *WOW*, 35 F.3d at 1414 (App. 10). With respect to Smith Barney's "due diligence" defense, the court held that petitioners had waived appeal of the issue by failing to mention it in their opening brief. *Id.* at 1424 (App. 36).

Petitioners next petitioned the court of appeals for a rehearing and sought *en banc* review by the entire court. No judge on the appellate panel voted to rehear the matter, and no judge on the entire court requested a vote on rehearing *en banc* (App. 51). Still unsatisfied, the petitioners have now repackaged the very same fact-intensive challenges to the decisions below as a Petition for Writ of Certiorari to this Court. Although four "questions" have been presented to the Court, the only issue involving Smith Barney is whether this Court should now second-

guess the careful and thorough evidentiary determinations made by two lower courts.[3]

SUMMARY OF ARGUMENT

Petitioners have presented no question worthy of the Court's attention. No conflict among the courts of appeal is offered, no unsettled question of federal law is advanced. Sup. Ct. Rule 10. Instead, devoting twice as much of their petition to factual contentions as to legal points, petitioners merely belabor yet again the tired claim they have repeated throughout this "tortured" litigation: the lower courts failed properly to apply settled law to petitioners' attempted portrayal of the facts.

Petitioners do not object to the court of appeals' legal analysis of the WOW prospectus disclosures. They concede that the "bespeaks caution" label employed by the court below is "essentially shorthand for the well-established principle that a statement or omission must be considered in context." Petition ("Pet.") at p. 24. Similarly, there is no real disagreement as to the proper scope of the bespeaks caution doctrine. The court of appeals, and the district court before it, expressly premised their decisions on the proposition that cautionary statements ***cannot*** immunize misstatements on a *per se* basis or cure omissions concerning ***existing facts***. *WOW*, 814 F. Supp.

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[3] While the petition focuses primarily upon the issues concerning proof of scienter under Section 10(b) of the 1934 Act as to the auditors, corporate officers and directors, none of these issues affects the summary judgment in favor of Smith Barney.

at 858; *WOW*, 35 F.3d at 1414 (App. 12). Thus, the interpretation that petitioners have urged on this Court ***is not in dispute.***

In reality, this petition simply rehashes petitioners' disagreement with the factual determinations reached by the district court (after five years of litigation) and the court of appeals (after its *de novo* review). Those prior decisions were painstakingly made after the courts "thoroughly reviewed the record", *WOW*, 814 F. Supp. at 873, and an "avalanche of documents presented by plaintiffs." *WOW*, 35 F.3d at 1420 (App. 27). Because the decisions below were properly founded on a compelling evidentiary record, and an unchallenged legal analysis – and because this Court "do[es] not grant *certiorari* to review evidence and discuss specific facts," *United States* v. *Johnson*, 268 U.S. 220, 227 (1925) – this petition should be denied.

Weak as they are, petitioners' proffered reasons for granting review cannot compare with the poverty of their attempt to make Smith Barney a party to that review. In the courts below, petitioners all but ignored Smith Barney, as epitomized by their addressing Smith Barney in just a single paragraph of their 80-page opening brief to the court of appeals. Their appeal took no issue with the district court's rulings that Smith Barney lacked scienter with respect to the 1934 Act claim and established a "due diligence" defense with respect to the 1933 Act claims. As to the latter, the court of appeals specifically held that petitioners had waived appeal of the issue by failing to mention it in their opening brief.

Nowhere in the questions or arguments they present to this Court do petitioners challenge the lower courts' rulings that Smith Barney lacked scienter and established a due diligence defense. For this reason, Smith Barney respectfully submits that review should be denied as to it regardless of the Court's response to the questions presented by petitioners.

REASONS FOR DENYING THE WRIT

1. Petitioners Complain Only Of The Lower Courts' Application Of Settled Law To A Detailed Factual Record And Suggest No Reason That Could Support The Exercise Of This Court's Discretionary Jurisdiction

This Court's exercise of its discretionary jurisdiction to review petitions for writs of certiorari is limited to cases where "there are special and important reasons therefor." Sup. Ct. Rule 10.1. With respect to those portions of the present petition that concern Smith Barney, there plainly are no such reasons. Indeed, these petitioners do not identify ***any legal issue*** requiring resolution by this Court in their request for still another hearing on their claims. It is well-established that "the jurisdiction of the Supreme Court to review cases by way of certiorari was not conferred upon this Court merely to give the defeated party in the Circuit Court of Appeals another hearing." *Magnum Co.* v. *Coty*, 262 U.S. 159, 163 (1923).

Significantly, petitioners do not contend that the court of appeals' legal analysis is in conflict with that of

any state court or other court of appeals. The petitioners concede that " 'the bespeaks caution doctrine' is merely 'new nomenclature rather than a substantive change in the law.' " Pet. at p. 24, quoting *In re Donald J. Trump Casino Sec. Litig.*, 7 F.3d 357, 364 (3d Cir. 1993), *cert. denied*, 114 S. Ct. 1219 (1994). Petitioners ***agree*** that the appellate court's invocation of the "bespeaks caution" shorthand simply stands for the proposition that prospectus disclosures "must be analyzed in context." Pet. at p. 24, quoting *Rubinstein* v. *Collins*, 20 F.3d 160, 168 (5th Cir. 1994).

Instead, petitioners challenge only the purported application of these uncontested legal principles. Petitioners argue that the court below applied the "bespeaks caution" doctrine as a *per se* rule, "under which the mere fact that the prospectus addressed a particular subject automatically excuses any and all misrepresentations or omissions regarding that subject." Pet. at p. 4. Petitioners further contend that the court below "improperly applie[d] the so-called 'bespeaks caution doctrine' to hold that disclosures of potential risks in a securities prospectus rendered the defendants' misrepresentation and omissions of existing fact immaterial under § 11, § 12(2) and § 10(b)." Pet. at p. 3. With respect to both of these contentions, petitioners hopelessly misstate the conclusions of the court below and ignore the express basis for its decision.

Contrary to petitioners' mischaracterization, the court of appeals' decision in *WOW* **rejected** a *per se* application of the "bespeaks caution" doctrine. The court below repeatedly cautioned that it was applying the doctrine "narrowly," *WOW*, 35 F.3d at 1414 (App. 12), that its

approach was "context-specific," *id.* at 1415 (App. 12), and that its "measured application" of the doctrine required an individualized analysis of the particular disclosures and alleged misstatements. *Id.* at 1414 (App. 11). Indeed, the *WOW* court quoted approvingly and extensively the Fifth Circuit's decision in *Rubinstein* v. *Collins*, 20 F.3d at 167 and n.26, which specifically ***disapproved of*** a *per se* approach in favor of a "fact-and-case specific" analysis.[4] *WOW*, 35 F.3d at 1414-15 (App. 10-12).

Although petitioners contend that the *WOW* decision somehow applied the "bespeaks caution" doctrine as a *per se* rule, other courts that have read the opinion suffer from no such confusion. In *Kaplan* v. *Rose*, 49 F.3d 1363, 1373 (9th Cir. 1994), another panel of the Ninth Circuit recently observed that the *WOW* decision was limited to "precise cautionary language [that] directly addresses itself to future projections, estimates or forecasts in a prospectus." The *Kaplan* court acknowledged the logic of "bespeaks caution" as set forth in the *WOW* decision, and concluded that the cautionary language before it ***did not*** relate directly to the statements at issue. *Id.*

Similarly, petitioners wholly misrepresent the decisions below with their claim that the court of appeals applied the "bespeaks caution" doctrine to immunize

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[4] In fact, the *Rubinstein* court's application of a context-based "bespeaks caution" analysis – which was expressly endorsed by the *WOW* panel – came in the context of the Fifth Circuit's ***reversal*** of a summary judgment that had been granted in favor of defendants based on a *per se* rule.

misstatements of *existing* facts. In truth, the court carefully limited its application of the bespeaks caution doctrine to risk disclosure "which directly addresses itself to future projections, estimates or forecasts in a prospectus." *WOW*, 35 F.3d at 1414 (App. 12). In fact, while the petitioners now pretend that the *WOW* decision is inconsistent with the Fifth Circuit's observation in *Huddleston* v. *Herman & MacLean*, 640 F.2d 534, 544 (5th Cir. 1981) ("to caution that it is only possible for . . . unfavorable events to happen when they have already occurred is deceit"), the district court in *WOW* specifically relied upon the same passage in ***dismissing*** petitioners' claims. *WOW*, 814 F. Supp. at 858.

In its decision below, the court of appeals thoroughly examined, *de novo*, all of the prospectus disclosures and the known risks ***at the time of the offering***. With respect to each of the arguments again raised by petitioners, the court below demonstrably followed the proper analysis (emphasis added in each quotation): (a) concerning WOW's liquidity, the court below concluded that "plaintiffs presented no evidence that, ***at the time of the offering***, it was foreseeable that $80 million would be insufficient . . . ," 35 F.3d at 1416 (App. 15-16); (b) concerning WOW's internal controls, the court below recognized both that the prospectus disclosed several *existing* problems, and that "the plaintiffs presented no evidence that WOW's internal controls ***at the time of the offering*** were materially deficient," *id.* at 1417 (App. 18); (c) concerning WOW's sales, the court below separately examined each challenged sales practice and found that none of them "posed a foreseeable risk to WOW's interests ***at the time of the Debenture Offering***," *id.* at 1417-18 (App. 19); and (d) concerning WOW's sales prospects, the

court below again found "no admissible evidence to show that WOW's sales had decreased so dramatically, ***at the time of the Debenture Offering,***" *id* at 1419 (App. 24), and concluded that "[plaintiffs'] argument distills to a contention that WOW should have predicted the collapse in sales that occurred in late 1987, long after the Debenture Offering." *Id.* at 1420 (App. 26).

Finally, petitioners contend that each of these determinations by the court of appeals should now be second-guessed. This half-hearted plea is not based upon any suggestion that the court below employed an improper legal standard in its Rule 56 analysis. It is uncontested that the court of appeals conducted a *de novo* review of the district court's grant of summary judgment and concluded that:

> "In doing so, we are mindful that although materiality and scienter are both fact-specific issues which should ordinarily be left to the trier of fact, summary judgment may be granted in appropriate cases." *WOW*, 35 F.3d at 1412 (App. 6), quoting *Hanson* v. *Dataproducts Corp.*, 976 F.2d 497, 500 (9th Cir. 1992).

Instead, petitioners argue the court below failed to indulge inferences that might have prevented summary judgment in this matter.

In reality, this Court has emphasized that when a defendant presents evidence that undermines any element of a claim, plaintiffs must "come forward with specific facts showing there is a genuine issue for trial."

Celotex Corp. v. *Catrett*, 477 U.S. 317, 324 (1986).[5] The Court below combed the evidentiary record (as had the district court) and found no such genuine factual issues. The *WOW* court concluded (as had the district court) that:

> "Plaintiffs have submitted hundreds of pages to this court in an effort to create a genuine issue of fact. Using tortured reasoning, convolution of the issues, and the benefit of hindsight, they point to the most innocuous of optimistic language, and the most immaterial of omitted facts, and claim that they were somehow misled as to the nature of their investment. [That is not sufficient]."

35 F.2d at 1420 (App. 28), quoting *WOW*, 814 F. Supp. at 873.

This Court has observed that "summary judgment procedure is properly regarded not as a disfavored procedural shortcut, but rather as an integral part of the Federal Rules." *Celotex Corp. v. Catrett*, 477 U.S. at 327. While petitioners are surely disappointed that the courts below actually devoted the time, energy and resources necessary to scrutinize their claims, there is no basis for this Court's reexamination of the lower courts' careful and measured application of Rule 56. *Graver Mfg. Co. v.*

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[5] *See also Anderson* v. *Liberty Lobby, Inc.*, 477 U.S. 242, 252-54 (1986) (the non-moving party must show that there are "genuine factual issues that properly can be resolved only by a finder of fact because they may reasonably be resolved in favor of either party"); *Matsushita Elec. Indus. Co.* v. *Zenith Radio*, 475 U.S. 574, 586 (1986) (in order to survive summary judgment plaintiffs "must do more than show that there is some metaphysical doubt").

Linde Co., 336 U.S. 271, 275 (1949) ("[R]ather than a court for correction of errors in fact finding, [the Supreme Court] cannot undertake to review concurrent findings of fact by two courts below in the absence of a very obvious and exceptional show of error.").

2. Petitioners Have Ignored Two Independent Grounds For Affirming The Judgment Below In Favor Of Smith Barney

Petitioners' failure to mention Smith Barney with anything beyond a passing reference in their petition continues a pattern evident throughout the eight-year history of this litigation. In the district court, Smith Barney established its "due diligence" and lack of scienter with 180 pages of declaration testimony from 15 witnesses who participated in the underwriting of WOW's securities offerings. Petitioners did not challenge a single word of that testimony, thereby compelling the district court's conclusion that Smith Barney possessed a due diligence defense to petitioners' 1933 Act claims, *WOW*, 814 F. Supp. at 867-68, and lacked scienter as to petitioners' 1934 Act claim. *Id.* at 873.

In the court of appeals, petitioners did not even argue the scienter issue as to Smith Barney. Nor did they challenge the district court's conclusion that Smith Barney was entitled to judgment on its due diligence defense. As to the latter, the court of appeals specifically ruled that petitioners had waived the issue on appeal by failing to argue it in their opening brief. 35 F.3d at 1423-24 (App. 36).

In this Court as well, petitioners have chosen to ignore Smith Barney. While they urge the Court to review the absence of scienter found by the court of appeals as to the officers, directors and venture capitalists, Pet. at pp. 27-29, they say nothing about the now-final determination that ***Smith Barney*** lacked scienter. They say nothing about the due diligence defense as to ***any*** respondent, thereby conceding the finality of that determination as well.

Because petitioners have abandoned any challenge as to Smith Barney's due diligence and lack of scienter, neither this Court's review nor a reversal on any of the questions presented could resurrect either a 1933 Act or 1934 Act claim against Smith Barney. As to Smith Barney, the judgment below is beyond meaningful review. Accordingly, certiorari as to Smith Barney in particular should be denied for this reason in addition to the poverty of the petition as to all respondents.

CONCLUSION

For the foregoing reasons, the Court should deny the Petition for a Writ of Certiorari to the extent that it seeks review of the summary judgment granted in favor of Smith Barney.

Respectfully submitted,

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